SUPREME COURT, U. S.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

No. 914

GEORGE R. TOLLEFSEN and MARGARET A. TOLLEFSEN,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered in the above-entitled case on June 19, 1970.

Opinions Below

The opinion of the Court of Appeals, as yet unreported, is printed in the Appendix, *infra*, pp. 1a-8a. The opinion of the Tax Court of the United States is reported at 52 T.C. 671, and is printed in the Appendix, *infra*, pp. 9a-26a.

Jurisdiction

The judgment of the Court of Appeals was entered on June 19, 1970. By order of this Court, dated September 16, 1970, Mr. Justice John M. Harlan, extended the time

for filing this petition for writ of certiorari to and including October 31, 1970. The jurisdiction of this Court is invoked under 28 U.S.C. Sec. 1254(1).

Questions Presented

1. Did the Court below err when it determined that the Tax Court's decision finding that advances to petitioner by subsidiary-corporation in amount of $24,665.40 during 1961 were not intended as a loan to him, as contended by petitioners, but were constructive dividends received by them from parent-corporation, within the purview of Secs. 301 and 316, I.R.C., was not clearly erroneous and should be affirmed?

2. Did the Court below err in its judgment that such advances to petitioner by subsidiary, were dividends from parent, when the two corporations were *bona fide*, active and successful corporations and retained their separate taxable entities, and there was no proof in the record that source of the funds came from parent and that subsidiary was used as a conduit or subservient instrumentality or a device to escape taxation?

3. Did the Court below err in its judgment that such advances were constructive dividends from parent, when neither petitioner was ever a shareholder of subsidiary and there was no provision in the Internal Revenue Code or Regulations which authorized the rule of attribution and construction adopted?

4. Did the Court below err in rendering judgment that such advances were dividends from parent, when the only

issue raised by the statutory notice of deficiency and the pleadings, and heard by the Tax Court, was whether such advances were dividends from subsidiary?

5. Was the petitioners' right to due process of law, as guaranteed by Fifth Amendment, violated when Court below entered judgment that petitioners received the taxable dividend from parent, and the notice of deficiency, pleadings and evidence heard by Tax Court were confined to the issue whether subsidiary paid such dividend, and Commissioner never charged or alleged that such dividend was paid by parent, and the Tax Court never tried such issue?

Statutes Involved

The pertinent provisions of Sections 243(a)(1), 301(a) and (c), 316(a), 6212(a) and (c), and 6214(a), of the Internal Revenue Code, 1954 (26 U.S.C.), are printed in the Appendix, *infra*, pp. 27a-29a.

Statement of the Case

(1)

The following facts were established in the record by stipulations of the parties and uncontradicted testimony of the petitioner, George R. Tollefsen:

In the years involved herein, and for a number of years prior thereto, the petitioners owned all of the stock of Tollefsen Bros., Inc. (hereinafter called "parent"), and the parent owned all of the stock of Tollefsen Manufacturing Corp. (hereinafter called "subsidiary").

For many years the petitioner was an appointed Commissioner of the State Insurance Fund of New York and an Executive-Trustee of a Savings Bank. He was either a Chairman or a member of several committees in both organizations concerned with investments, budgets and mortgages (R. 21a-23a).[1]

Since 1933, the petitioner has been engaged in the organization and operation, and as sole or principal stockholder, of over 25 corporations. He served as an officer and director of such corporations. On an average, 8 or 10 of these corporations have been in existence each year (R. 23a).

During these years, he personally made loans to almost all of the 25 corporations, and on occasion he or his wife personally borrowed money from some of them (R. 23a-25a). Though these corporations had an established line of credit with their bank, he preferred to lend them money personally whenever they required a loan (R. 46a). Of these corporations, there were three, including parent and subsidiary, to which they lent money and from which they had borrowed (R. 25a). On all of the loans to and from these corporations, it was their practice never to charge interest to the corporations, and no interest would be charged to them by the corporations (R. 46a).

As of December 31, 1961, they lent about $170,000 to six of these corporations, and borrowed about $70,000 from two of them (R. 27a, 50a-51a).

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[1] All "R." references are to the numbered pages of the separately bound agreed Appendix filed in the Court of Appeals, and certified by the Clerk of said Court and filed with the Clerk of this Court.

As of December 31, 1961, and as of date of trial, they personally owned marketable securities, deposits in savings banks and other liquid assets, in excess of $225,000; two homes worth more than $105,000 (without any mortgage on them); the stocks in the corporations they had organized and operated, which had a net book value in excess of $200,000 and a fair market value in excess of such book value; and $170,000 in loans receivable due from six of these corporations. Their personal debts were very few and very nominal in amount (R. 27a, 29a-32a, 50a-51a).

Parent was incorporated in 1933. In addition to owning all of stock of subsidiary and another corporation, it was actively engaged in business, owning real estate, land and machinery, leasing real estate, and purchasing and selling real estate, land and other properties (R. 26a-28a). As of December 31, 1961, the book value of its capital stock was $127,000, and its fair market value was over $315,000 (R. 28a-29a).

Subsidiary was incorporated on December 19, 1955. It was actively engaged in business manufacturing mineral shot and grit, used as abrasive materials in cleaning of ships (R. 58a, 67a).

During 1955 and 1956, petitioner personally loaned subsidiary a total of $1,790.54, which was entered on its books as a loan payable to him; and such loan was repaid to him in 1957 (R. 32a-33a, 47a). In 1959, he also loaned subsidiary a total of $7,149.18, which was similarly entered on its books as a loan payable to him (R. 47a, 108a).

On March 8, 1960, subsidiary sold its fixed assets; and it and petitioner covenanted with vendee not to manufacture

or sell abrasive materials for five years within continental United States (R. 33a-35a, 67a).

Thereafter, petitioner was in a dilemma whether to liquidate subsidiary into parent, under a tax-free liquidation, or to keep its separate entity. In his business judgment, he decided not to liquidate subsidiary at that time because of its good will and important business contacts in the abrasive field (R. 33a-34a).

He then decided that for the best interests of subsidiary, he would borrow money from it for purpose of investigating and developing new methods of producing abrasive materials, and that he would invest personally in related ventures in maritime industry until end of restrictive period. Then he would decide again whether to liquidate subsidiary into parent, or to operate it separately with the new techniques he had uncovered (R. 33a-35a, 46a).

During 1960, he borrowed from subsidiary a total of $34,960.15, and after deducting the $7,149.18 due to him for his advances, he owed the net balance of $27,810.97 for 1960. During 1961, he borrowed a total of $27,000, and after deducting $2,334.60 due to him for his advances, he owed the net balance of $24,665.40 for 1961 (R. 108a).

These advances to petitioner were entered on all of subsidiary's books, records and tax returns, as a loan receivable, owed to it by petitioner. He gave his promissory notes to subsidiary, each time he borrowed from it. He and subsidiary treated and considered these advances at all times as a loan made to him (R. 36a-38a, 108a, 109a-114a).

He testified that when he borrowed such funds, he intended that repayment would be made in full, and that, at

all times thereafter, it was his intention to repay such loan in full (R. 39a, 44a-45a).

During 1960 and 1961, and in 1964, with the $52,000 borrowed from subsidiary and other personal funds, he expended $5,000 on trips to Norway to investigate new methods of producing abrasive materials, and loaned and invested over $115,000 in several corporations related to the maritime industry (R. 35a-36a, 39a-40a).

Between January 31, 1964 and May 11, 1964, he assigned to parent certain claims and a mortgage due to him, in total amount of $88,587.40, and an additional claim due to him for $4,500 on November 30, 1964 (R. 38a, 56a, 101a).

On January 31, 1964 (and prior to a week before June 4, 1964), he realized the fact and was considering whether to offset the debt he owed subsidiary by the larger debt owed to him by parent, or to liquidate subsidiary into parent at that time, which would result in paying his debt in full to subsidiary, as parent owed him more than he owed subsidiary (R. 38a, 53a-54a).

On June 4, 1964, the Revenue Agent began the tax examination of subsidiary which resulted in the notice of deficiency in this case. Subsidiary received letter from said Agent notifying it of his impending examination of its books and records not more than a week or so before June 4, 1964 (R. 53a-54a).

As of date of trial, the claims and mortgage assigned by petitioner to parent, in total amount of $93,087.40, had been paid in full to parent by the respective debtors, except for balance of $7,500 due on the mortgage, and that mortgage was secured by real estate worth about $150,000 (R. 38a, 56a).

Between November 30, 1964 and March 11, 1968, petitioner made advances to subsidiary, and, in its behalf, made a special investment of 50% in a new abrasive processing company and a loan to such company, in total amount of $11,916.80. These amounts were credited by subsidiary to his loan receivable account on its books. These credits paid in full the first two notes and part of the third note issued by petitioner to subsidiary, and were so marked on back of notes (R. 37a, 100a, 110a).

After termination of period under restrictive covenant, petitioner intended that balance of his debt to subsidiary would be paid in full either by offset against larger debt still owed to him by parent, or by liquidating subsidiary into parent, or by his direct payment to it and operating it independently. His uncertainty as to which course would be best to follow was due to the pendency of this tax case (R. 37a-38a, 60a).

For the years 1960 and 1961, petitioners filed income tax returns reporting total adjusted gross income of $30,646.22 and $44,139.66, respectively, and paid income taxes of $3,820.87 and $9,177.39, respectively (R. 70a-77a, 122a-133a).

The advances made to petitioner during 1961 by subsidiary were identical in every respect with those made to him during 1960; similar promissory notes were given during both years; and the books, records and tax returns of subsidiary reflected the same treatment for the advances made during both years, as loans made to him by subsidiary (R. 36a-37a, 40a, 108a, 109a-114a).

Petitioners and District Director signed official Form 872 in March, 1964, which extended period of limitation for

assessment of petitioners' income tax return for 1960, until June 30, 1965 (R. 121a).

(2)

Despite the above evidence, which was not refuted by any testimony or other proofs submitted by the Commissioner, the Tax Court determined that the withdrawals from the subsidiary were not intended as a loan to the petitioner because "at the time of the withdrawals here in issue Tollefsen did not intend to repay such amounts to (subsidiary)"; and then concluded that such withdrawals "were in effect dividends from (parent), petitioners' wholly owned corporation." It made this conclusion even though it found that the two were "separate" corporations, and that the parent "owned 100 percent of the stock of (subsidiary)" and the petitioners were never "record owners of stock in (subsidiary)."

It declared that the ground for such holding was that the petitioner "controlled" subsidiary "through the ownership of all the stock in its parent company" and, therefore, such withdrawals "came to him *through* (parent)" (emphasis by Court) and were "in substance" the distributions of two dividends, first the distribution of a constructive dividend to parent by subsidiary, "with a resulting constructive dividend to petitioners" by parent.

The Court cited no provision in the Code nor any case as authority for such holding. It merely referred to several Tax Court cases for purposes of "comparison."

These cases, as noted by the Court of Appeals, represented two theories. Under the first, the Tax Court "looked through the form of the corporate organization and

recognized the individual taxpayer as a 'shareholder' of the distributing corporation within the purview of section 301(a), *Ben R. Meyer*, 45 B.T.A. 228, 237-38 (1941)." And, under the second, the Tax Court "analyzed the whole transaction as in reality consisting of an indirect distribution from the parent which distribution was caused to be paid from the controlled subsidiary as a conduit, *Jacob M. Kaplan*, 43 T.C. 580, 592 (1965)."

These contrary case references, together with the facts: (a) the notice of deficiency and the pleadings raised only the one issue whether the petitioner received a taxable dividend from subsidiary (as described below, in detail); (b) the Tax Court tried only that one issue; and (c) the contrary findings of the Court that the two corporations were "separate" for the purpose of an effective repayment of the loan, but for the purpose of determining a taxable distribution it found that the withdrawals from subsidiary were received by the petitioner "through" parent, made it very confusing and unclear as to the true basis for the Tax Court's holding.

(3)

The Court of Appeals declared that the Tax Court's determination as to whether the "withdrawal is a loan or dividend is a question of fact which a circuit court of appeals cannot alter unless the determination is not supported by substantial evidence"; and that, "In the case at bar we cannot say that the Tax Court lacked a substantial basis in drawing the inference that there was no intent to repay."

It then affirmed the "Tax Court's holding that the withdrawals were dividends from (parent)."

Similarly, it cited no provision in the Code as authority for such holding. And, as to case authority, it noted that there was no reported appellate case involving the additional factor "of a parent corporation as a vehicle through which the taxpayer controls the corporation from which the withdrawal was made." Then it referred to the two Tax Court cases of *Meyer* and *Kaplan*, described above, which were "compared" by the Tax Court in the instant case, and declared, "We regard the situation at bar to be closer to *Kaplan* than to *Meyer*. Indeed, the Commissioner eschews reliance upon *Meyer* in his brief. Appellee's brief at 21."

The Court of Appeals made its determination despite the substantial evidence and uncontradicted testimony of the petitioner that such withdrawals from subsidiary were intended as a loan to him and were in effect repaid in full before the tax audit began; the several material errors committed by the Tax Court in the rendition of its judgment against the petitioners, as described below; the notice of deficiency, the pleadings and the evidence heard by the Tax Court were limited solely to the issue whether the petitioner received a dividend from subsidiary; the petitioner's right to due process of law was violated in rendering a judgment against him that he received a dividend from parent, which was not supported by the notice of deficiency and the pleadings and was not litigated by the parties; the lack of proof in the record that the funds withdrawn from subsidiary were derived from parent, and that such withdrawals were intended as a "device" to "divert" funds and to "avoid income taxation"; the Tax Court never found that subsidiary was employed as a "conduit"; and the fact that there was no provision in the Code or Regulations which would support such determination.

(4)

In his report against the petitioner, the Revenue Agent specifically determined that he was charged "with a dividend from (subsidiary), 11/30/61," because of his withdrawals from such corporation during 1961 (R. 10a). In his statutory notice of deficiency, the Commissioner determined that petitioner's withdrawals from subsidiary during 1961 constituted a dividend (R. 10a). (Note: No reference was made in either the report or notice that such withdrawals from subsidiary was a dividend or "constructive dividend" from parent.)

In their petition to the Tax Court, the petitioners alleged that they received no taxable dividend from subsidiary during 1961; they never owned any stock in such corporation; and that the advances to petitioner exceeded the amount of such corporation's earned surplus (R. 4a-7a).

In his answer, the Commissioner merely denied these allegations (R. 12a-13a). (Note: No allegation was made in the answer that such withdrawals from subsidiary was a dividend or "constructive dividend" from parent.)

At the trial before the Tax Court, in refutation of the charge that he received a dividend from subsidiary, the petitioner testified and offered proofs that he did not receive a dividend from subsidiary; that neither he nor his wife ever owned any stock in such corporation; that parent owned all of the stock of subsidiary; and that parent was an active and substantive corporation for many years. The Commissioner offered no evidence to contradict such facts; and, in particular, offered no evidence to establish that the dividend was paid by parent. (Note: The issue as to whether the petitioner received a dividend from parent was

never raised at the trial, nor even intimated or discussed by either party.)

In his opening statement to the Tax Court, the Commissioner's attorney stated that the petitioners received the dividend from subsidiary because they owned all of the stock of parent, and parent owned all of the stock of subsidiary; and that "the respondent cites the case of *Ben R. Meyer*, 45 B.T.A. 228, 1941, which, with regard to this particular question, is squarely on point" (R. 20a).

In his brief filed with the Tax Court, the Commissioner stated his point that, "For the purpose of determining the existence of a dividend, petitioner should be treated as a shareholder of (subsidiary)." He argued, "It cannot be contended that because the petitioners were not the record owners of (subsidiary's) stock, that they could not have received a dividend from that company." And, he concluded that, "the petitioners, by virtue of their ownership of (parent), should be deemed, for the purposes of determining whether a dividend has been paid, to be the owners of (subsidiary's) stock. Since petitioners in substance were the owners of and in control of (subsidiary), a holding to the contrary would allow form to prevail over substance" (pages 15-17).

Then, on pages 7-8 of said brief, the Commissioner requested the Tax Court to find as ultimate facts that, "For the purpose of determining the existence of a dividend, petitioner was a shareholder of (subsidiary) during 1961," and that the withdrawals from such subsidiary "constitute unreported distributions of property made by a corporation to a shareholder with respect to its stock out of earnings and profits."

Reasons for Granting the Writ

1.

The decision below conflicts with numerous decisions of this Court declaring active business corporations to be separate taxable entities, and that ownership and control of such corporations do not determine taxability.

The decisions of the Courts below, which rest on the theory that merely because petitioners owned all of the stock of parent, and parent owned all of the stock of subsidiary, their respective taxable entities may be ignored, and the receipt of funds by petitioner from such subsidiary may be deemed to have come to him as a "constructive dividend" from parent, even though there was no proof in the record that the source of these funds was derived directly or indirectly from such parent, and that such withdrawals were intended as a "device" to divert funds from subsidiary as part of a "fictional corporate camouflage," are in direct conflict with a number of decisions of this Court.

This Court has determined that when a corporation's "purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity." Its separate entity is retained whether its stock is owned entirely (or partly) by another corporation or by an individual, and regardless of the quantum of such business activity. *Moline Properties, Inc.* v. *Commissioner,* 319 U.S. 436, 438-439 (1943); *National Carbide Corp.* v. *Commissioner,* 336 U.S. 422 (1949).

In the instant case, the evidence established that the two corporations were *bona fide*, active and successful corporations, and retained their separate taxable entities. The Tax Court determined that they were "separate" corporations. Also, the Commissioner acknowledged on pages 12, 19 and 21 of his brief filed in the Court below that the two corporations were "*bona fide* separate corporations" and had "separate entities."

In addition, this Court has determined that "complete ownership of the corporation, and the control primarily dependent upon such ownership * * * are no longer of significance in determining taxability." *National Carbide Corp.* v. *Commissioner, supra,* at page 429; *Burnet* v. *Commonwealth Improvement Co.,* 287 U.S. 415 (1932).

Thus, the mere fact that petitioners owned all of the stock of parent, should not subject them to a tax on funds received by them from its wholly-owned subsidiary, as a "constructive dividend" paid by parent, when the two corporations were separate and distinct taxable entities and there was no proof of "diversion" or "device" employed. The relationship between a corporation "and its shareholders is an abiding one. They obtain the dividend payments because of their status as shareholders." *United States* v. *Joliet & Chicago R. Co.,* 315 U.S. 44, 48 (1942).

This Court should resolve such conflict. To permit the decision of the Court below to stand would create confusion and uncertainty in the relationship between a corporation and its shareholders, and in the significance and meaning of "separate taxable entity" for many thousands of active corporations throughout the country. This Court for many

years has established clear and practical guides for such concepts; these should not be thwarted or ignored.

2.

The decisions of the Courts below are in conflict with each other; the case of *Jacob M. Kaplan*, 43 T.C. 580, cited by the Court of Appeals, as representing a similar basis for its holding, is clearly not in point.

The Tax Court determined that the withdrawals by petitioner from subsidiary were "in substance" two constructive dividend distributions, subsidiary to parent, and then parent to petitioners. While the Court of Appeals determined that only one dividend distribution was made, and that it was similar to the situation presented in the prior Tax Court case, *Jacob M. Kaplan*, 43 T.C. 580 (1965), "an indirect distribution from the parent which distribution was caused to be paid from the controlled subsidiary as a conduit."

(Note: If the theory of the Tax Court had been followed, then the first constructive dividend distribution by subsidiary to parent would be subject to the special deduction of 85% of such amount, or $20,965.59 to be deducted from the distribution in question, $24,665.40, leaving a net taxable dividend of $3,699.81. Such deduction was specifically allowed by Sec. 243(a)(1), I.R.C., when a corporation received a dividend from another corporation. Then, at most, only $3,699.81 could be distributed by parent to petitioners in the second constructive dividend distribution, and not the full amount of $24,665.40, as determined by the Tax Court.)

The Court of Appeals changed the Tax Court's theory of two distributions, and followed the holding of the *Kaplan* case, even though neither the Tax Court found nor the facts established that the subsidiary was used as a "conduit" to divert such distribution. (The Court noted in its opinion that even the Commissioner in its brief before such Court had changed its theory of the case from the principle set forth in the *Meyer* case, to that of the *Kaplan* case.)

In the *Kaplan* case, the Court found a plan among the petitioner therein, parent and subsidiary which "was a fictitious maneuver that was nothing more than a sham"; that substantial "assets were shifted" (almost $3,000,000, net) from the parent to the "newly created" subsidiary; that the subsidiary "was in no financial position to participate, through its own volition, in the plan which petitioner formulated"; and that "the source of all the withdrawals which petitioner received in 1952 was the funds of (parent) which (subsidiary) then possessed through forbearance of its said parent corporation." The Tax Court concluded that such withdrawals of $1,000,000 from the subsidiary were dividends paid by parent, and were "taxable as dividends to the extent of (parent's) earnings and profits" as the petitioner had caused such distribution "to be paid to him through the medium of (subsidiary), as a conduit and subservient instrumentality."

Said cited case was clearly not in point, as no facts were established in the record herein (and neither did the Tax Court so find) that the source of the advances to petitioner herein was the funds of the parent, or that the subsidiary was used as a "conduit" or "subservient instrumentality" or a "device to escape taxation."

Settlement of the issue raised herein concerning the employment of a corporation as a "conduit" is in the public interest. The interpretation given by the Court below, without proof that the source of the funds came from the parent and that there existed a plan to "divert" such funds through the subsidiary "as a conduit and subservient instrumentality," sets forth a view which is clearly contrary to the fundamental concepts in taxation of dividends received from a parent or a subsidiary corporation. Widespread litigation will most certainly follow if this issue is not settled by this Court.

3.

The decision below is contrary to the fundamental concepts of the law of taxation under the Internal Revenue Code that income may not be created where none existed, and where no provision in the Code or Regulations authorized the rule of construction adopted.

Neither decision in the Courts below cited any provision in the Code or Regulations (it is submitted, that no such provision exists) which would support their determinations that the advances made to petitioner by subsidiary in the amount of $24,665.40 was a constructive dividend paid by parent in that amount, within the purview of Secs. 301 and 316, I.R.C., merely because of the shareholdings of the respective corporations as presented herein. (Neither Court found any facts in the record herein to support their determinations that petitioner received a "constructive dividend" from parent, beyond the "cold" facts that petitioners "owned 100 percent of the stock of (parent) and the latter owned 100 percent of the stock of (subsidiary).")

In Sec. 318, I.R.C., the Congress enacted a detailed provision concerning rules of control, attribution and constructive ownership of stock, as they affect other provisions of the Code. In subsection (b), eight other sections of the Code are listed in which such rules of control and constructive ownership of stock, as contained in subsection (a) thereof, "are expressly made applicable." Neither Sec. 301 or 316, providing for "dividends" distributed "by a corporation to its shareholders" is listed therein. If the Congress intended that an individual owning all (or a fixed percentage) of the stock of a parent-corporation shall be constructively the recipient of a dividend from parent, when such "dividend" is distributed by subsidiary, then such provision would have been "expressly made applicable" by the addition of Sec. 301 or 316 to said subsection (b) of Sec. 318.

Accordingly, without grant of authority under the Code, the decision of the Court below was erroneous as a matter of law as it "set up income where none existed" (*Tennessee-Arkansas Gravel Co.* v. *Commissioner*, 112 F.2d 508, CA 6, 1940) and as it was contrary to the principle established by this Court that such factors of ownership of stock and control dependent upon such ownership "are no longer of significance in determining taxability."

The issue whether a taxpayer may be taxed on "income" where it was arbitrarily "created" and "none existed," and without grant of authority under the Code for a special rule of attribution and constructive ownership of stock which may "set up" such income from a "constructive dividend," should be settled by this Court. It is of great importance and significance in the sound administration of the income tax law under the Code.

4.

The judgment of Court below, that petitioners received the dividend in question from parent, was erroneous as a matter of law, as neither the notice of deficiency nor the pleadings made such issue, and the Tax Court never tried such issue; the Tax Court and the Court of Appeals were without jurisdiction to make such redetermination.

The statutory notice of deficiency, the pleadings and the evidence heard by the Tax Court were confined to the issue whether subsidiary paid a taxable dividend in amount of $24,665.40 to petitioner.

Nowhere in such notice and pleadings was the issue ever made or alleged that petitioner received such taxable dividend from parent, directly, indirectly or constructively. Also, at the trial before the Tax Court, no evidence was presented, and the Commissioner did not even argue or contend, that parent paid such dividend to petitioner, whether directly, indirectly or constructively.

Accordingly, the decision of the Court below affirming the "Tax Court's holding that the withdrawals were dividends from (parent)," was erroneous as a matter of law. It was contrary to the well-established principle adopted by all Courts and all legal authorities that a judgment based on an issue not made by the pleadings and not litigated between the parties, is *"coram non judice* and void."

In tax cases under the Code, such principle must be even more stringently applied. Pursuant to Sec. 6214(a), I.R.C., the jurisdiction of the Tax Court is limited only "to redetermine the correct amount of the deficiency" and to de-

termine whether any "additional amount" should be assessed, if the Commissioner asserted a claim therefor "at or before the hearing" of the case.

Thus, the Tax Court and the Court of Appeals were without authority under the Code to enter a completely new and different judgment that the dividend in question was paid by parent, when the Commissioner determined in his notice of deficiency that such dividend was paid by subsidiary; and, at the same time, such judgment was void under general law, as the issue whether the dividend was paid by parent was never made by the pleadings and never litigated by the parties.

Further, even if the Commissioner had desired to assert the new determination that the dividend was paid during the same taxable year by parent, he was barred from making such additional determination under Sec. 6212(c), I.R.C., after he had mailed his original notice of deficiency and the petitioner had filed a timely petition with the Tax Court.

Actually, the Commissioner never amended his statutory notice of deficiency or his answer filed with the Tax Court. His charge and determination at all times was that the dividend was paid by subsidiary.

In addition, throughout the hearing before the Tax Court, the Commissioner contended that the principle set forth in the *Meyer* case, "is squarely on point"; and, for the purpose of determining whether petitioner received a dividend from subsidiary, he was a "shareholder" of subsidiary.

This Court should settle whether a judgment which conflicts with the specific provisions of the Code concerning the limits of the Tax Court's jurisdiction, and which is

contrary to fundamental principles of legality adopted by all legal authorities and all Courts, should be permitted to stand. The limits of the Tax Court's jurisdiction should be defined by this Court, as a matter of public interest and as a guide for all taxpayers.

5.

The judgment of the Court below violated the petitioners' right to due process of law, as guaranteed by the Fifth Amendment.

Until "the Commissioner eschew(ed) reliance upon *Meyer* in his brief" filed in the Court of Appeals (as noted by the Court in its opinion) and until said Court rendered its judgment "that the withdrawals were dividends from (parent)," the notice of deficiency, the pleadings and the hearing before the Tax Court were directed and presented by the Commissioner against the petitioners herein on the charge that they received the dividend in question from subsidiary; that they were the "shareholders" of subsidiary, even though he acknowledged and the Tax Court found that parent "owned 100 percent of the stock of (subsidiary)"; and that the *Meyer* case was "squarely on point."

In view of the notice of deficiency and the pleadings herein, the petitioner confined his testimony and proofs at the trial before the Tax Court to prove: he did not receive a taxable dividend from subsidiary; neither he nor his wife was ever a shareholder of subsidiary; parent owned all of the stock of subsidiary; parent was a *bona fide*, active and successful corporation, and not a "shell" or "dummy" or "sham or unreal" corporation; and parent retained its separate taxable entity.

The Commissioner introduced no evidence to refute these facts, but merely contended that the petitioners received the dividend from subsidiary and that they were the "shareholders" of subsidiary, "by virtue of their ownership of (parent)."

Accordingly, the petitioners respectfully submit, that their right to due process of law, as guaranteed by the Fifth Amendment, had been violated when the Court below entered judgment affirming the judgment of the Tax Court, and holding that the petitioners received the taxable dividend from parent.

The petitioners were entitled to proper judicial proceedings as guaranteed by the Constitution and as provided under the Internal Revenue Code. As the issue, whether they received the taxable dividend in question from parent was not before the Tax Court (and was never in fact "tried" by the Court)—neither the notice of deficiency nor the pleadings made or alleged such charge or issue—the petitioners submitted no evidence on such issue, the Commissioner offered no evidence on such issue, and the Tax Court never conducted a "hearing" on such issue. Therefore, the petitioners never had their "day in Court" on such issue.

The violation of petitioners' rights on this point may further be noted when the Court below declared that its holding that the withdrawals were dividends from parent, "makes irrelevant Tollefsen's arguments that (parent) cannot be considered a 'shell' or a 'dummy' corporation and that he cannot be considered a 'shareholder' of (subsidiary)." The Court ignored the principle that the petitioners' proofs and testimony on these facts were definitely relevant, if it and the Tax Court had exercised their jurisdiction as provided under the Code and as guaranteed by the

Constitution, and redetermined only the issue charged by the notice of deficiency and raised by the pleadings.

In addition, when the Court below discussed its proposed findings as to which corporation paid the dividend in question, it declared that the case "must be explicit in articulating the theory under which Tollefsen can be said to have received a 'dividend.'" Yet, it violated its own rule when it entered the judgment holding that parent paid the dividend to petitioner, even though it was aware that the notice of deficiency, the pleadings and the evidence heard by the Tax Court were directed solely to the issue whether subsidiary paid such dividend.

This Court should settle in the public interest whether the fundamental requirement of due process of law, "notice, and an opportunity to be heard and to defend in an orderly proceeding adapted to the nature of the case," may be ignored by the Commissioner in his attempts "to collect the revenue."

6.

The Court below erred, as a matter of law, when it affirmed the judgment of the Tax Court, which was clearly erroneous, void and entered in violation of petitioners' right to due process of law under Fifth Amendment.

The Tax Court committed the following errors when it entered judgment that the advances to petitioner during 1961 by subsidiary, were constructive dividends paid to petitioners by parent:

1. It stated that no evidence was presented to establish the fair market value of the claims assigned by petitioner to parent. Petitioner's uncontradicted testimony was that these claims and mortgage assigned to parent were paid in full as of date of trial, except for a balance of $7,500 due on the mortgage and that mortgage was secured by real property worth $150,000.

2. It stated that no evidence was presented to establish that these assignments to parent were intended as repayments of withdrawals from subsidiary. Petitioner's uncontradicted testimony was that because parent owed him more than he owed subsidiary he considered his debt paid in full; also, he considered whether to offset such debt by the larger debt due to him by parent, or to liquidate subsidiary into parent, which would also result in paying his debt in full.

3. It stated that the promissory notes given by petitioner to subsidiary for these advances to him, bore no interest and no interest was paid thereon. Petitioner's uncontradicted

testimony was that on all loans made by petitioners to the corporations he had organized and operated, and on the loans made by these corporations to the petitioners, it was their practice never to charge interest to the corporations, and no interest would be charged to them by the corporations.

4. It stated that petitioner made no payments on account of the amounts withdrawn during 1960 and 1961. The petitioner's uncontradicted testimony and the parties' stipulation of facts established that $7,149.18 advanced by petitioner in 1959 was credited by subsidiary against the amount withdrawn in 1960; that $2,334.60 advanced by petitioner in 1961 was credited by subsidiary against amounts withdrawn in 1960 and 1961; and that $11,916.80 advanced by petitioner from November 30, 1964 to March 11, 1968 was credited by subsidiary against amounts withdrawn in 1960 and 1961. In addition, petitioner's uncontradicted testimony was that he considered his debt to subsidiary paid in full because parent owed him more than he owed subsidiary, as described above.

5. It stated that there was no pattern of reciprocal loans to and from his corporations, and no showing of any such pattern of reciprocal loans "of consequence" to subsidiary. The petitioner's uncontradicted testimony and the parties' stipulation of facts established that he made loans to and from parent in amounts larger than the sum borrowed from subsidiary; and that he made loans for $1,790.54 and $7,149.18 to subsidiary prior to 1960 (and these amounts were certainly "of consequence" compared to his debt of $24,665.40 questioned by the Commissioner). In addition,

petitioner's uncontradicted testimony was that petitioners frequently made loans to the corporations he organized and operated, and on occasion they borrowed from such corporations; that as of December 31, 1961, they lent $170,000 to six of these corporations, and borrowed about $70,000 from two of them; that it was their practice never to charge or be charged interest on the many loans made to and from such corporations.

6. When petitioner testified that his advances of $170,000 to six of the corporations, as of December 31, 1961, were loans made by petitioners to these corporations, it stated that that was his "conclusory description of such advances," and that it would not accept such testimony as these advances "may well have been capital contributions." The petitioner testified in great detail that he frequently made loans to almost all of the corporations he organized and operated; that though these corporations had an established line of credit with their bank, he preferred to lend them money personally whenever they required a loan; and that, as of December 31, 1961, the petitioners lent a total of $170,000 to six of these corporations. The Commissioner did not cross-examine or question the petitioner on such testimony at the trial, as to whether such advances of $170,000 might represent something other than "loans"; and neither did the Commissioner introduce any evidence to refute such direct testimony. From the date the tax examination began to the date of trial, a period of four years, the Commissioner had conducted detailed examinations and hearings (and received affidavits and other proofs from petitioners) by his Revenue Agent, his Review Staff, his Conference Division, his Appellate Division, and his Regional Counsel. Certainly, he had full opportunity to challenge

the veracity of such direct testimony. Further, the Court overlooked the fact that it specifically found that, "Tollefsen at times made interest-free personal loans to some of his corporations."

7. It found that parent and subsidiary were "separate" corporations for the purpose of disputing an effective repayment of the loan from subsidiary, because of the larger debt due to petitioner by parent, yet, for the purpose of determining the taxability of such advances to petitioner, it found that these funds were received by petitioner "through" parent. Such inconsistent findings were unreasonable and arbitrary.

8. It stated that its confidence in petitioner's testimony was "greatly shook" because he testified that he borrowed the money from subsidiary for purpose of carrying on its business interest, during the five-year period under the restrictive covenant against himself and subsidiary, and then he employed most of such funds to acquire other business interests in his own name. Such gratuitous statement by the Court was definitely baseless. The Court overlooked the fact that out of the total of $93,837.40, in claims and mortgage assigned by petitioner to parent in 1964, $73,837.40 represented his claim against Port O'Call Corp.; and that he had made investments and loans to such corporation with part of the funds he had borrowed from subsidiary. Thus, as parent owned all of the stock of subsidiary, as such assigned claim was almost three times as large as his loan being questioned, as he always considered his debt to subsidiary offset by such assignments to parent, and as he frequently considered liquidating subsidiary into parent, in a tax-free liquidation, there was certainly

nothing "unusual" about his employment of the borrowed funds as described. Further, the petitioner testified that he was in a dilemma as to the best course to follow, and that he exercised his business judgment to the best of his ability, in making such investments in his own name for the time being and until the restrictive covenant had terminated. When the petitioner exercised his business judgment to the best of his ability, and which he believed was for the best interest of subsidiary, that should not be disturbing to the Court, unless it had been established in the record that he had fabricated his testimony or that he possessed a base motive in the exercise of such judgment. Clearly, neither of these had been proved, nor even intimated, by the Commissioner.

9. The Revenue Agent and the Court acknowledged, and the facts established, that the withdrawals during 1960 and 1961 represented one continuing transaction, and that those made during 1961 were identical in every respect with those made during 1960. The Court erred, as a matter of law, when it upheld the Commissioner's determination that the 1961 withdrawals were "dividends" while those made during 1960 were accepted by him as "loans." When the Revenue Agent examined the records of subsidiary and petitioners in 1964, the Commissioner had until June 30, 1965 under the formal agreement made between him and the petitioners, and until April 15, 1967, under Sec. 6501(e)(1), I.R.C., to make an assessment against petitioners on the withdrawals made during 1960. It would be unreasonable and arbitrary to accept the view that Commissioner "included only the 1961 return because he thought the statute of limitations had run on the 1960 return," as a legal basis for waiving his "inconsistent" and "unequal" deter-

minations in this situation. The Courts have frequently held that there is a duty upon the Commissioner, as well as the taxpayer, to be consistent and equal in his treatment of a transaction which continues from year to year. "In income taxation what is done in one tax year is sometimes projected into another where the same fact must govern. There being continuity, there ought to be consistency in treatment. * * * It is no more right to allow a party to blow hot and cold as suits his interests in tax matters than in other relationships. Whether it be called estoppel, or a duty of consistency, or the fixing of a fact by agreement, the fact fixed for one year ought to remain fixed in all its consequences." (*Alamo Nat. Bank* v. *Commissioner*, 95 F.2d 622, 623, CA 5, 1938.)

10. Without grant of authority under the Code, the Court erred, as a matter of law, when it determined that withdrawals from subsidiary, were "constructive dividends" paid by parent, merely because petitioners owned all of the stock of parent, and parent owned all of the stock of subsidiary. If the Congress had intended such special rule of attribution and constructive ownership to be applied in the case of "withdrawals" from subsidiary, to be attributed as a "dividend" from parent, it would have made such appropriate provision in Sec. 318, I.R.C.

11. The Court erred, as a matter of law, in rendering its judgment that the petitioners were taxable on the dividends paid by parent, as it was without jurisdiction under the Code to make its redetermination that the petitioners were taxable for dividends paid by parent, when the statutory notice of deficiency charged that the dividends were paid to them by subsidiary; it was void, as the notice of de-

ficiency, the pleadings and the evidence heard by the Court were confined to the issue whether subsidiary paid such dividends; and it was entered in violation of the petitioners' right to due process of law under the Fifth Amendment, as they never had "notice, and an opportunity to be heard and to defend in an orderly proceeding" on such issue, and, actually, the Court never tried such issue.

Accordingly, after examining the above errors, weighing the undisputed facts presented in the record by the parties' stipulation of facts and the uncontradicted testimony of petitioner, and noting that there was no proof in the record that the source of the funds advanced to petitioner came from parent or that such advances were intended as a "device" to "divert" the funds and to "avoid income taxation," it is submitted, that the Court below erred, as a matter of law, in affirming the judgment of the Tax Court.

This Court should settle in the public interest the important questions presented in this case. These include the problems of "controlled" corporations in a parent-subsidiary relationship; the application of rules of attribution and constructive ownership of stock in a "dividend" situation, without grant of authority under the Code; the duty imposed upon Commissioner and the taxpayer to be consistent and equal in the treatment for tax purposes of a transaction which continues from year to year; the limits and extent of the jurisdiction granted to the Tax Court under the Code; the significance of a proper statutory notice of deficiency and an orderly hearing by the Tax Court to redetermine the correct amount of the deficiency; the fundamental right granted under the Constitution to be duly cited and to be heard on the issue determined by the Tax Court; and the weight to be given to a judgment

rendered by the Tax Court under the Code, when the record established that numerous errors had been committed as a matter of law and that its rendition was clearly erroneous.

CONCLUSION

For the reasons set forth above, it is respectfully submitted that this petition for a writ of certiorari should be granted.

Respectfully submitted,

MURRAY KURMAN
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October 28, 1970

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UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 582—September Term, 1969.

(Argued April 23, 1970 Decided June 19, 1970.)

Docket No. 34203

GEORGE R. TOLLEFSEN and
MARGARET A. TOLLEFSEN,

Appellants,

—against—

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

Before:

MOORE and SMITH, *Circuit Judges;*
WEINFELD,* *District Judge.*

Appeal from a decision of the Tax Court of the United States, Arnold Raum, *Judge*, entered July 24, 1969, which determined a deficiency in the taxpayers' income tax for the year 1961 in the amount of $13,029.91. The findings of fact and opinion of law of the Tax Court are reported at 52 T.C. 671 (1969).

Affirmed.

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* Of the Southern District of New York, sitting by designation.

MURRAY KURMAN, New York, N. Y., *for Appellants.*

WILLIAM K. HOGAN, Attorney, Department of Justice, Washington, D. C. (Johnnie M. Walters, Assistant Attorney General, Lee A. Jackson and William Massar, Attorneys, Department of Justice, Washington, D. C., of counsel), *for Appellee.*

MOORE, *Circuit Judge*:

On this appeal we are asked to review the determination of the Tax Court that the withdrawals by George R. Tollefsen from Tollefsen Manufacturing Corp., the wholly-owned subsidiary of Tollefsen Brothers, Inc., which in turn was owned by Tollefsen and his wife (taxpayers), were taxable dividends and not loans.

The facts were fully developed at an evidentiary proceeding before Judge Raum and in the findings that he filed with his opinion on July 24, 1969. 52 T.C. 671 (1969). For present purposes we will recite only those facts needed to present the circumstances in broad outline.

Tollefsen maintained control over a number of corporations in which he was the sole or principal shareholder. Among these was Tollefsen Brothers, Inc., incorporated in 1933 and owned by Tollefsen and his wife. From 1950 to 1955 that corporation had an exclusive contract to sell and distribute the products of Baldwin Hill Co., a manufacturer of abrasives. In 1955 Tollefsen Manufacturing Corp. was organized to carry on the manufacture of abrasives. To that end the fixed assets of Baldwin Hill were sold to Tollefsen Brothers and then transferred to Tollefsen Manufacturing. Eighty per cent of the stock of the

newly organized Tollefsen Manufacturing was held by Tollefsen Brothers; the remaining twenty per cent, by a Mr. Hellerman, a former salesman for Tollefsen Brothers.

In 1960 another arrangement was devised. Hellerman organized Anchor Abrasive Corp. for the purpose of purchasing the fixed assets of Tollefsen Manufacturing. Hellerman's twenty per cent interest in Tollefsen Manufacturing was sold to Tollefsen Brothers. Tollefsen and Tollefsen Manufacturing covenanted not to compete in the abrasives field for five years. Tollefsen decided not to liquidate Tollefsen Manufacturing into Tollefsen Brothers for at least the five years during which competition was restricted. The net result of this transaction is that Tollefsen Manufacturing became a wholly-owned inactive subsidiary of Tollefsen Brothers.

Tollefsen began making cash withdrawals from Tollefsen Manufacturing after it had become an inactive wholly-owned subsidiary of Tollefsen Brothers. A net withdrawal of $27,810.97 was made in 1960 and $24,665.40, in 1961. These amounts were reflected on Tollefsen Manufacturing's books as loans receivable, for which Tollefsen delivered promissory notes payable to Tollefsen Manufacturing. The money withdrawn was used by Tollefsen to go to Norway to investigate abrasives productions and to acquire interests, in his own name, in Nordic Ship Blasting Inc., Hose-McCann Electronics Corp., and Port-O'Call Corp. In June, 1964 the Internal Revenue Service began the audit which eventually culminated in the notice of deficiency in question in these proceedings. Thereafter from November 1964 until the date of the Tax Court hearing, credits in the amount of $11,916.80 were made in the account with Tollefsen Manufacturing. Two notes were marked to indicate repayment. During 1964 and 1965 Tol-

lefsen assigned certain "claims" due him to Tollefsen Brothers, so that there was a credit balance in his account with Tollefsen Brothers in the amount of $43,166.46.

The Tax Court upheld the Commissioner's determination that the withdrawals from Tollefsen Manufacturing during 1961 constituted taxable dividends. The court concluded that "at the time of the withdrawals here in issue Tollefsen did not intend to repay such amounts to Tollefsen Manufacturing." 52 T.C. 671, 678. Having made this factual finding, the court concluded that the amounts "were in substance distributions to Tollefsen Bros. from its subsidiary Tollefsen Manufacturing, with a resulting constructive dividend to petitioners, the sole shareholders of Tollefsen Bros." 52 T.C. 671, 681.

It is an often repeated principle of tax law that the form into which a taxpayer casts a transaction will not obliterate the tax consequences that emerge from the substance of the transaction. This principle has been applied to situations wherein shareholders of a closely held corporation have made withdrawals in the form of "loans" which have been treated as a "distribution of property . . . made by a corporation to a shareholder with respect to its stock . . ." for the purposes of section 301 of the Internal Revenue Code. E.g., *Regensburg* v. *Commissioner*, 144 F.2d 41 (2d Cir.), *cert. denied*, 323 U.S. 783 (1944); *Oyster Shell Prods. Corp.* v. *Commissioner*, 313 F.2d 449 (2d Cir. 1963). The controlling question in making such a determination, as recognized by the Tax Court, is whether there was an intent to make a loan, i.e., whether repayment was in fact contemplated by the parties. The courts have considered many factors to find outward manifestations of such an intent. See, Comment, Disguised Dividends: A Comprehensive Survey, 3 U.C.L.A. L. Rev. 207, 222-28 (1956);

Werner, Stockholder Withdrawals—Loans or Dividends? 10 Tax L. Rev. 569 (1955). The determination of whether the withdrawal is a loan or a dividend is a question of fact which a circuit court of appeals cannot alter unless the determination is not supported by substantial evidence. *Commissioner* v. *Scottish American Co.*, 323 U.S. 119, 123-24 (1944); *Regensburg* v. *Commissioner, supra; Sala* v. *Commissioner,* 146 F.2d 228 (2d Cir. 1944); cf. *United States* v. *Stanton,* 287 F.2d 876 (2d Cir. 1961) (review of district court).

In the case at bar we cannot say that the Tax Court lacked a substantial basis in drawing the inference that there was no intent to repay. Support for the determination is found in the facts that there was no formal repayment until after the audit was begun, that the withdrawals were used to acquire personal interests in business ventures and the assignment of claims to Tollefsen Brothers was not intended to discharge the obligation to Tollefsen Manufacturing. In evaluating the demeanor of Tollefsen, whose testimony would be important in establishing the intent of the transaction, the court stated that its confidence was "greatly shook" by his statement that the withdrawals were to carry on the activities of Tollefsen Manufacturing during the period of competition restriction. 52 T.C. 671, 679. Such an explanation was "completely spurious" since Tollefsen himself was equally restrained by the covenant not to compete. *Id.* The court also rejected explanations offered by Tollefsen that his financial ability to repay the "loans" indicated an intention to do so and that this withdrawal was a part of a pattern of bona fide reciprocal loans to and from his corporations.

A distribution made by a corporation to a shareholder with respect to its stock is a dividend, and so includable in

gross income, if it is made out of current or accumulated earnings and profits. Int. Rev. Code of 1954, §§301(b), 316(a). As of December 31, 1961, Tollefsen Brothers had "earned surplus and undivided profits" in the amount of $72,019.48. As of November 30, 1961, Tollefsen Manufacturing has a similar account in the amount of $38,357.29. From 1956 to the date of the hearing below, neither corporation had ever declared and paid a dividend. The earnings and profits of either corporation would have been sufficient to make a $24,665.40 distribution in 1961 constitute a "dividend." Nevertheless, the court must be explicit in articulating the theory under which Tollefsen can be said to have received a "dividend."[1]

The presence of a parent corporation as a vehicle through which the taxpayer controls the corporation from which the withdrawal was made adds a factor which was not present in *Regensburg, supra,* or *Oyster Shell, supra.* Earlier cases confronted with this additional formal complication have adopted one of two approaches. They have either looked through the form of the corporate organization and recognized the individual taxpayer as a "shareholder" of the distributing corporation within the purview of section 301(a), *Ben R. Meyer,* 45 B.T.A. 228, 237-38 (1941); or, they have analyzed the whole transaction as in reality con-

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1 "The characterization of an amount received by a shareholder, directly or indirectly, from his corporation may be important in determining (a) whether the corporation may deduct it, (b) whether it reduces the corporation's current earnings and profits in computing taxability of current distributions or merely reduces the earnings available for future distributions, (c) whether the recipient must treat it as ordinary gross income under §61(a) or may treat it in whole or in part as a return of capital under §301(c), and (d) whether the recipient is entitled to the dividends received exclusion of §116 or intercorporate dividends received deduction of §243."

Bittker & Eustice, Federal Income Taxation of Corporations and Shareholders 166 (2d ed. 1966).

sisting of an indirect distribution from the parent which distribution was caused to be paid from the controlled subsidiary as a conduit, *Jacob M. Kaplan*, 43 T.C. 580, 592 (1965). In *Meyer* the distributions were taxable as dividends to the extent of the subsidiary's earnings and profits, while in *Kaplan* they were taxable to the extent of the parent's earnings and profits. In the case at bar, the court characterized the transaction as in reality consisting of two steps—"a transfer from Tollefsen Manufacturing to its parent, followed by a transfer from the parent to Tollefsen." 52 T.C. 671, 681. Both *Meyer* and *Kaplan* are cited in the Tax Court's opinion. We regard the situation at bar to be closer to *Kaplan* than to *Meyer*. Indeed, the Commissioner eschews reliance upon *Meyer* in his brief. Appellee's brief at 21. Any differences between *Kaplan* and the case at bar would be reflected in the tax consequences to the corporate entities—an issue not now before us.

We affirm the Tax Court's holding that the withdrawals were dividends from Tollefsen Brothers. This holding makes irrelevant Tollefsen's arguments that Tollefsen Brothers cannot be considered a "shell" or a "dummy" corporation and that he cannot be considered a "shareholder" of Tollefsen Manufacturing. No advantage is to be derived from section 243(a)(1) of the Code, providing an eighty-five per cent deduction for certain qualifying intercorporate dividends, since that section on its face applies only to corporate, not individual, taxpayers. As stated above, the tax consequences to the corporations involved are not before us.

There is no merit in the argument that the Commissioner is estopped from treating the 1961 withdrawals as dividends without urging similar treatment for the 1960 withdrawals. When the Commissioner issued his formal

notice of deficiency in January 1967, he included only the 1961 return because he thought the statute of limitations had run on the 1960 return. Now it is revealed that a six-year limitations period was applicable and a deficiency notice for the 1960 return would have been timely. Int. Rev. Code of 1954, §6501(e)(1). Such a mistake of law is not a circumstance which calls for the invocation of the doctrine of equitable estoppel. See *Automobile Club of Michigan* v. *Commissioner*, 353 U.S. 180 (1957); *Caldwell* v. *Commissioner*, 202 F.2d 112, 115 (2d Cir. 1953).

The decision of the Tax Court is affirmed.

Opinion of the Tax Court of the United States

52 T.C. 671

TAX COURT OF THE UNITED STATES

GEORGE R. TOLLEFSEN and MARGARET A. TOLLEFSEN,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 1743-67. Filed July 24, 1969.

T owned all the stock in A corporation. A corporation was in turn the sole shareholder of B corporation. B corporation sold for cash all its assets and manufacturing rights within the continental United States to a party unrelated to T and became inactive. Thereafter, T immediately began making cash withdrawals from B corporation which were evidenced by non-interest bearing "notes." *Held,* the net withdrawals from B corporation during the year in issue were not bona fide loans to T but, as a result of T's control over A and B corporations, were constructive dividends to T from A corporation.

Murray Kurman, for the petitioners.
Richard J. Mandell, for the respondent.

The Commissioner determined a deficiency in petitioners' 1961 income tax in the amount of $13,029.91. The only issue is whether $24,665.40 received by petitioner George R. Tollefsen during 1961 from Tollefsen Manufacturing Corp., a corporation controlled by him, is taxable to petitioners as a dividend under sections 301 and 316, I.R.C. 1954.

Findings of Fact

Some of the facts are stipulated and are incorporated herein by reference.

The petitioners, George R. Tollefsen and Margaret A. Tollefsen, are husband and wife. They resided in Brooklyn, N. Y., at the time of the filing of their petition herein. They filed a joint income tax return for the calendar year 1961 with the district director of internal revenue, at Brooklyn, N. Y.

From 1933 to the date of the hearing herein petitioner George R. Tollefsen (Tollefsen) has been engaged in the organization and operation of a number of corporations in which he was the sole or principal shareholder or over which he maintained control. To date, he has organized approximately 25 different corporations and he has served as an officer and director of such corporations during the periods of their existence. On the average, 6 to 10 of Tollefsen's corporations have been in existence every year since 1933.

Tollefsen at times made interest-free personal loans to some of his corporations. As of December 31, 1961, he had made advances to six of his corporations in the aggregate

amount of about $170,000 which were characterized as "loans." Tollefsen rarely borrowed from his corporations.

During 1961 Tollefsen alone, or in conjunction with his wife, owned all, or at least 50 percent of the stock of six corporations. One of these corporations was Tollefsen Bros., Inc. (Tollefsen Bros.), which was incorporated on October 19, 1933, under the laws of the State of New York. From 1940 to the date of the hearing in this case Tollefsen and his wife owned all of the stock of Tollefsen Bros. He also was president of that corporation, and was paid a salary for his services in that capacity. Tollefsen Bros. is essentially a holding company, though it owns and operates certain real estate and machinery. For its taxable year ended December 31, 1961, it reported total income of $9,486.66 from rents, dividends, and capital gains and taxable income of $1,259.06. As of that date, it had "earned surplus and undivided profits" in the amount of $72,019.48. It has not paid a dividend, at least from 1956 to the date of the hearing herein, and the record does not disclose that it ever paid a dividend.

From sometime in 1950 to December 19, 1955, Tollefsen Bros. had an exclusive contract with Baldwin Hill Co. (Baldwin), a manufacturer of mineral shot and grit products used as abrasive materials in the cleaning of ships and tanks, for the sale and distribution of these products throughout the world. In 1955 Baldwin discontinued its manufacturing operations and sold its fixed assets to Tollefsen Bros. On December 19, 1955 Tollefsen Manufacturing Corp. (Tollefsen Manufacturing), a New York corporation, was organized for the purpose of carrying on the foregoing business of manufacturing and producing mineral shot and grit. Tollefsen became the president of Tollefsen

Manufacturing. Tollefsen Sales Corp. (Tollefsen Sales) was also organized at the same time to carry on the sales activities of Tollefsen Manufacturing.

On January 30, 1956, Tollefsen Manufacturing issued 68 shares of its common stock, without par value, to Tollefsen Bros., at a fixed value of $200 per share, and for which shares Tollefsen Bros. paid $13,600. These 68 shares represented 80 percent of all the stock in Tollefsen Manufacturing. The remaining 20 percent was purchased by a Mr. Hellerman, a former salesman of Tollefsen Bros. Tollefsen Bros. and Hellerman held the same proportionate share of the stock of Tollefsen Sales. The record does not disclose how the fixed assets of the manufacturing business found their way into the hands of Tollefsen Manufacturing, or whether such assets were accounted for in the $13,600 purchase price of the 68 shares of stock.

During 1955 and 1956 Tollefsen, personally, made advances to and on behalf of Tollefsen Manufacturing in the total amount of $1,790.54. These advances were recorded on the books of Tollefsen Manufacturing as an account payable. Tollefsen was repaid for these advances by Tollefsen Manufacturing in January of 1957.

Tollefsen Manufacturing operated as a manufacturer of mineral shot and grit products until March 8, 1960. At that time, it sold for $65,000 its machinery, equipment, and other fixed assets, together with all its rights to manufacture mineral shot and grit, to Anchor Abrasive Corp., a corporation organized by Hellerman for the purpose of purchasing such assets. At the same time, Hellerman sold to Tollefsen Bros. his 20-percent stock interest in Tollefsen Manufacturing, which resulted in making Tollefsen Bros. the sole owner of the stock of Tollefsen Manufacturing.

Also, as part of the sales agreement, Tollefsen, Tollefsen Manufacturing, and Tollefsen Sales agreed "not to manufacture and/or sell abrasive blasting materials or to be or become in anywise interested in any entity engaging in such activity" in the continental United States for a period of 5 years.

After the above sale had been completed Tollefsen Manufacturing became inactive. On its income tax return for the fiscal year ended November 30, 1961, it reported no operating income and claimed a loss of $204.84; it was a personal holding company for that year. Tollefsen considered liquidating Tollefsen Manufacturing into its parent, Tollefsen Bros., but decided instead that Tollefsen Manufacturing should retain its corporate form at least until the end of the 5-year period during which its activities were restricted.

Tollefsen began making cash withdrawals from Tollefsen Manufacturing during 1960, after the completion of the above sale and after Tollefsen Bros. became the owner of all the stock in Tollefsen Manufacturing. The payable and receivable accounts of Tollefsen Manufacturing showed the following cash withdrawals by Tollefsen during 1960:

June 30	$10,000
August 31	5,000
October 31	10,000
November 30	9,500
Total	34,500

After certain credits (including accrued salary as of November 30, 1959, in the amount of $6,143.18), the net amount withdrawn by Tollefsen during 1960 totaled $27,810.97.

During 1961, Tollefsen made cash withdrawals from Tollefsen Manufacturing in the net amount of $24,665.40, as follows:

Cash withdrawals		Credits	
Feb. 14	$5,000	May 31	[1] $ 434.50
Feb. 27	5,000	Nov. 30	[1] 1,552.00
Apr. 30	5,000	Nov. 30	[2] 348.10
May 2	5,000		
May 12	3,000		
Oct. 31	4,000		
Total	27,000		2,334.60
Net withdrawals	$24,665.40		

[1] Advances for "business development expenses."
[2] Accrued salary.

The net debit balance against Tollefsen as of January 1, 1962, was $32,476.37.

The amounts withdrawn by Tollefsen during 1960 and 1961 were reflected on the books of Tollefsen Manufacturing as loans receivable, and Tollefsen issued promissory notes in respect of his withdrawals from that corporation, dated and in the amounts as follows:

Date	*Amount*	*Date*	*Amount*
June 3, 1960	$ 2,850.82	Feb. 28, 1961	$10,000.00
Aug. 3, 1960	5,000.00	Apr. 3, 1961	5,000.00
Oct. 3, 1960	10,000.00	May 12, 1961	8,000.00
Nov. 30, 1960	9,960.15	Oct. 4, 1961	4,000.00
1960 Total	27,810.97	1961 Total	27,000.00

These notes were payable on demand to Tollefsen Manufacturing and bore no interest. No interest was paid at any time by Tollefsen in respect of the above cash withdrawals.

Tollefsen Manufacturing has not paid a dividend from the time of its incorporation to the date of the hearing herein. As of November 30, 1961, it had "earned surplus and undivided profits" in the amount of $38,357.29.

As of December 31, 1961, Tollefsen and his wife had substantial personal assets, including marketable securities having a net market value of approximately $150,000, savings bank accounts with deposits of approximately $26,000, two homes having a value of approximately $105,000, and an insurance policy having a net cash value of approximately $38,000. Other than Tollefsen's purported obligation with respect to the cash withdrawals from Tollefsen Manufacturing, noted above, Tollefsen had outstanding debts and obligations (not reflected in the net value of any of the foregoing assets) in the aggregate amount of approximately $23,500. The net book value of petitioners' corporations was in excess of $200,000, and the fair market value thereof was in excess of book value.

The funds withdrawn by Tollefsen from Tollefsen Manufacturing during 1960 and 1961 were used by him as follows:

(a) From $5,000 to $10,000 was expended by him in trips to Norway to investigate new methods of producing abrasive blasting materials.

(b) $8,000 was expended to acquire an interest in Nordic Ship Blasting, Inc., A.S., a Norwegian corporation. The record does not disclose the extent of the interest acquired, or the nature of the business conducted by this corporation. Title to the stock thus acquired was in petitioner's name.

(c) An amount estimated from $8,000 to $10,000 was expended for an interest in Hose-McCann Electronics Corp., a corporation engaged in electronics activities relating to the maritime industry. Title to this stock was in Tollefsen's name.

(d) $30,000 was expended for a 50-percent stock interest in Port O'Call Corp., a corporation which operated a marina. Title to this stock was in Tollefsen's name.

(e) The remainder was subsequently utilized to purchase the remaining 50-percent stock interest in Port O'Call Corp.

Tollefsen also made loans of additional amounts to Port O'Call Corp.

Title to none of the foregoing business interests or stock therein has ever been assigned to Tollefsen Manufacturing.

To the date of the present hearing, Tollefsen has made no formal repayments to Tollefsen Manufacturing in respect of the amounts withdrawn during 1960 and 1961, though certain amounts were credited to his account on the books of the corporation. These credits appear in the following schedule stipulated by the parties as "a transcript of the loan account with George R. Tollefsen on the books of Tollefsen Manufacturing Corp. setting forth the advances made" by Tollefsen to the corporation and by the corporation to Tollefsen from January 1, 1962, to the date of the hearing herein:

		Debits[1]		Credits[1]	
1962					
Jan. 1	Net debit balance	$52,476.37			
Oct. 29	Payroll tax paid for him	320.00			
Oct. 29	Payroll tax paid for him	2.00			
Dec. 26	Cash advanced to him	1,000.00			
			1964		
			Nov. 30	He advanced cash	$ 1,000.00
			Nov. 30	He advanced business development expenses ..	112.80
			1965		
			Nov. 30	He advanced business development expenses ..	138.15
			1966		
			Nov. 30	He advanced business development expenses ..	121.65
			1967		
			Nov. 30	He advanced business development expenses ..	288.20

[1] Explanations are summaries of entries on the books.

Debits[1]			Credits[1]	
		1967		
	Dec.	6	He advanced on account of 50% investment in Pellets Processing	$ 4,000.00
		1968		
	Jan.	22	He advanced on account of Pellets Processing —Investment	1,000.00
	Mar.	11	He advanced on account of Pellets Processing —Investment	2,500.00
	Mar.	11	He advanced on account of Pellets Processing Loan Receivable	2,806.30
Total debits ..	53,798.37		Total credits ..	11,916.80
		1968		
	May	29	Net debit Balance	41,881.57

[1] Explanations are summaries of entries on the books.

Pellets Processing, the company referred to in the above schedule, was organized by Tollefsen in 1967 to produce a new type of mineral shot.

The amounts so credited were sufficient to offset in full the first two notes issued by Tollefsen to Tollefsen Manufacturing during 1960, and those notes were marked so as to indicate their repayment. As of the date of the hearing herein no repayments have been made in respect of the 1961 withdrawals.

During 1964 and 1965 Tollefsen made assignments of his interest in Port O'Call Corp. and other "claims" to Tollefsen Bros. These assignments are reflected in the following schedule, which the parties have stipulated to be "a transcript of the loan account with George R. Tollefsen on the books of Tollefsen Bros., Inc. setting forth the advances made" by Tollefsen to that corporation and by it to Tollefsen from January 1, 1961, to the date of the hearing herein:

		Debits[1]	*Credits*[1]
1961			
Jan. 1	Net debit balance	37,926.23	
1964			
Jan. 31	Tollefsen assigned claims due to him from third party		$68,337.40
Mar. 31	He assigned claim due to him from third party		1,000.00

[1] Explanations are summaries of entries on the books.

Debits[1]			Credits[1]	
		May 11	He assigned mortgage due to him from third party	$19,250.00
		Nov. 30	He assigned claim due to him from third party	4,000.00
		1966		
		May 31	He advanced cash	5.29
1965				
Nov. 30	Cash advanced to him	2,000.00		
1967				
May 31	Cash advanced to him	5,000.00		
1968				
Apr. 30	Cash advanced to him	5,000.00		
	Total debits	49,926.23	Total credits	49,926.23
		1968		
		May 29	Net credit balance	43,166.46

[1] Explanations are summaries of entries on the books.

No evidence was presented to establish the fair market value of these "claims" nor was any evidence presented to establish that the assignments reflected in these book entries were intended as repayments in respect of Tollefsen's withdrawals from Tollefsen Manufacturing.

An audit of the books of Tollefsen Manufacturing was commenced by an agent of the Internal Revenue Service on or about June 4, 1964.

The Commissioner explained his determination of deficiency against petitioners for 1961 as follows: "It has been determined that your net withdrawals of $24,665.40 from the Tollefsen Manufacturing Corp. during the taxable year ended December 31, 1961 constitute a dividend to you."

Opinion

RAUM, *Judge*: The sole issue is whether the net withdrawals made by petitioner George R. Tollefsen from Tollefsen Manufacturing during 1961 constituted loans, as contended by the petitioners, or distributions of dividends, as contended by the Commissioner. Resolution of this issue requires us to determine first whether Tollefsen's withdrawals were intended as bona fide loans to him, or as permanent withdrawals. If the withdrawals were intended to be permanent, we must further determine whether petitioners received dividends notwithstanding they were not record owners of stock in Tollefsen Manufacturing.

Essential to our first inquiry is the determination of whether repayment of the advances was in fact contemplated by the parties at the time the withdrawals were made. See *Leach Corporation*, 30 T.C. 563, 579; *Hoguet Real Estate Corporation*, 30 T.C. 580, 598; 2554-58 *Creston Corp.*, 40 T.C. 932, 936-937; *Jacob M. Kaplan*, 43 T.C. 580;

Wiese v. Commissioner, 93 F. 2d 921, 923 (C.A. 8), certiorari denied 304 U.S. 562; Carl L. White, 17 T.C. 1362, 1368.

After consideration of all the evidence, we conclude that at the time of the withdrawals here in issue Tollefsen did not intend to repay such amounts to Tollefsen Manufacturing.

Tollefsen Manufacturing became inactive upon the sale of its assets and manufacturing rights to Anchor Abrasive Corp. in March of 1960. Shortly thereafter, Tollefsen began making systematic cash withdrawals from that corporation which, by the end of 1961, left the corporation virtually without any assets other than the "notes" given it by him in respect of the withdrawals. These "notes" were non-interest-bearing and no interest was at any time paid by Tollefsen to the corporation for the use of the funds withdrawn.

Tollefsen attempted to explain his withdrawals by arguing that it was necessary for him to effect "loans" from his corporation in order to "carry on" its interests during the period in which its activities were restricted by the terms of the sales agreement entered into with Anchor Abrasive Corp. But it is clear from the terms of the sales agreement that Tollefsen himself was personally bound by the identical limitations to which Tollefsen Manufacturing was subject during the 5-year period, and so far as those limitations were concerned he had no greater right or freedom to "carry on" its business interests in his personal capacity than as its agent using its own funds on its behalf without withdrawing them as loans to himself. His explanation that he withdrew the funds because of those contractual restrictions was completely spurious, and greatly shook our con-

fidence in his testimony. We simply did not believe it to the extent that it sought to establish an intention to repay the funds withdrawn.

Moreover, rather than using these funds to "carry on" the business interests of Tollefsen Manufacturing, Tollefsen expended most of the funds withdrawn in his own behalf to acquire personal interests in various business ventures. Tollefsen did not assign any of these interests to Tollefsen Manufacturing nor is there any convincing evidence that he intended to do so. While some amounts were spent by him for trips to Norway to explore new methods of synthesizing mineral shot—an activity of interest to Tollefsen Manufacturing—it is notable that the only tangible result of these trips was Tollefsen's acquisition of a *personal* interest in Nordic Ship Blasting, Inc., A.S. The nature of the business of this corporation does not appear in this record, and the interest therein purchased by Tollefsen has never been assigned to Tollefsen Manufacturing.

Our finding that Tollefsen did not intend to repay the amounts withdrawn is further supported by the fact that as of the date of the hearing herein he has made no formal repayments in respect of the amounts allegedly "borrowed" during 1960 and 1961. Those credits (aggregating $11,916.80) to Tollefsen's account on the books of Tollefsen Manufacturing which were treated as repayments in respect to Tollefsen's withdrawals (as further indicated by the cancellation of two notes given by Tollefsen with respect to withdrawals made in 1960) were unimpressive in light of the much larger net amounts withdrawn from the corporation ($52,476.37) during 1960 and 1961 and the period of time within which Tollefsen has had the unrestricted use of these funds. Moreover, these credits on the books of Tollef-

sen Manufacturing, beginning November 30, 1964, were made *after* the petitioners had notice of an audit by the Internal Revenue Service, which audit actually began on or about June 4, 1964—a circumstance that goes far to weaken these "repayments" as persuasive evidence of a pre-existing intention to repay the amounts withdrawn. Cf. *Atlanta Biltmore Hotel Corp.* v. *Commissioner*, 349 F. 2d 677, 680 (C.A. 5).

Tollefsen has argued that his intention to repay the advances in issue is evidenced by the fact that he was at all times financially able to repay the withdrawals. The short answer to this contention is that he offered no credible explanation of why he did not make such repayment. No evidence was presented to show a plan of repayment and little other than Tollefsen's own self-serving testimony suggested that at the time of withdrawal he intended to repay the advances, testimony that we did not find convincing.

Tollefsen has also argued that his withdrawals were "in effect" repaid in full prior to his notice of investigation by the Internal Revenue Service when, during early 1964, he made assignments of his interests in Port O'Call Corp. and other "claims" to Tollefsen Bros., the parent of Tollefsen Manufacturing. He argues that since these claims were in excess of the amounts allegedly due on the withdrawals from Tollefsen Manufacturing his "loans" were in effect repaid. This argument is completely without merit. The assignments made to Tollefsen Bros., no matter how voluntary or timely with respect to investigations of the Internal Revenue Service, were not intended to discharge Tollefsen's alleged obligation to Tollefsen Manufacturing, a separate corporation, and the parties did not in any way treat the assignments as such. At best this argument suggests

that Tollefsen could have made repayments to Tollefsen Manufacturing had he intended to do so; that he did not, however, is further indication that he did not in fact intend to repay the advances in issue.

Tollefsen attempts to make much out of the fact that he had made advances of some $170,000 to six of his corporations, thereby suggesting a pattern of bona fide reciprocal loans to and from his corporations. The difficulty with this contention is that there was no showing of any such pattern of reciprocal loans of consequence to *this* corporation, Tollefsen Manufacturing, particularly in the light of the fact that the so-called loans by this corporation to him in effect merely drained this corporation of its funds after it had become inactive when there was no convincing evidence that it would ever become active again.[1]

Having determined that Tollefsen's withdrawals from Tollefsen Manufacturing were not loans, we conclude that the amounts withdrawn from that corporation were in effect dividends from Tollefsen Bros., petitioners' wholly owned corporation. It is clear that Tollefsen exercised complete control over Tollefsen Manufacturing through the ownership of all the stock in its parent company Tollefsen Bros. He was able to siphon off the assets of Tollefsen Manufacturing only because petitioners owned 100 percent

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[1] In addition, it is far from clear that Tollefsen had made bona fide loans aggregating $170,000 to his other corporations. To be sure, he testified in conclusory terms, without meaningful amplification, that he made such loans, but although we have found that he made advances in such amount, we are not prepared to accept his characterization of such advances as loans. They may well have been capital contributions, and in the absence of any satisfactory clarifying testimony, we are not required to accept Tollefsen's conclusory description of such advances. The burden was on him, and we need not indulge in speculative assumptions in his favor.

of the stock of Tollefsen Bros. and the latter owned 100 percent of the stock of Tollefsen Manufacturing. In every real sense the funds in question came to him *through* Tollefsen Bros., notwithstanding that two steps (a transfer from Tollefsen Manufacturing to its parent, followed by a transfer from the parent to Tollefsen) were compressed into a single step, the transfer of funds directly to Tollefsen. We find, therefore, that the withdrawals in issue were in substance distributions to Tollefsen Bros. from its subsidiary Tollefsen Manufacturing, with a resulting constructive dividend to petitioners, the sole shareholders of Tollefsen Bros. Cf. *Ben R. Meyer*, 45 B.T.A. 228; *Jacob M. Kaplan*, 43 T.C. 580; *Sidney L. Olson*, 48 T.C. 855, 870-871, and supplemental opinion 49 T.C. 84; but cf. *Howard M. Taylor et al.*, 14 B.T.A. 863.

Finally, Tollefsen argues that since the Commissioner accepted his treatment of the 1960 withdrawals as "loans" the Government is now estopped or otherwise precluded from claiming that the 1961 withdrawals were dividends. We disagree. Regardless of whether the Commissioner had the opportunity to treat the withdrawals in both years in the same manner it is well established that the Commissioner is not subject to any estoppel or similar disability if he does not do so. *Dixon* v. *United States*, 381 U.S. 68; *Automobile Club* v. *Commissioner*, 353 U.S. 180; *Caldwell* v. *Commissioner*, 202 F. 2d 112, 115 (C.A. 2); *Chester Farrara*, 44 T.C. 189, 191. The mere fact that petitioners may have obtained a windfall in 1960 does not entitle them to like treatment in 1961.

Decision will be entered for the respondent.

Statutes Involved

Internal Revenue Code of 1954 (26 U.S.C.):

Sec. 243. Dividends Received by Corporations.

(a) GENERAL RULE.—In the case of a corporation, there shall be allowed as a deduction an amount equal to the following percentages of the amount received as dividends from a domestic corporation which is subject to taxation under this chapter:

(1) 85 percent, in the case of dividends other than dividends described in paragraph (2) or (3);

• • • • •

Sec. 301. Distributions of Property.

(a) IN GENERAL.—Except as otherwise provided in this chapter, a distribution of property (as defined in section 317(a)) made by a corporation to a shareholder with respect to its stock shall be treated in the manner provided in subsection (c).

• • • • •

(c) AMOUNT TAXABLE.—In the case of a distribution to which subsection (a) applies—

(1) AMOUNT CONSTITUTING DIVIDEND.—That portion of the distribution which is a dividend (as defined in section 316) shall be included in gross income.

• • • • •

Sec. 316. Dividend Defined.

(a) GENERAL RULE.—For purposes of this subtitle, the term "dividend" means any distribution of property made by a corporation to its shareholders—

(1) out of its earnings and profits accumulated after February 28, 1913, or

(2) out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

• • • • •

Sec. 6212. Notice of Deficiency.

(a) IN GENERAL.—If the Secretary or his delegate determines that there is a deficiency in respect of any tax imposed by subtitle A or B or chapter 42, he is authorized to send notice of such deficiency to the taxpayer by certified mail or registered mail.

• • • • •

(c) FURTHER DEFICIENCY LETTERS RESTRICTED.—

(1) GENERAL RULE.—If the Secretary or his delegate has mailed to the taxpayer a notice of deficiency as provided in subsection (a), and the taxpayer files a petition with the Tax Court within the time prescribed in section 6213(a), the Secretary or his delegate shall have no right to determine any additional deficiency of income tax for the same taxable year, • • • with respect to any act (or failure to act) to

which such petition relates, except in the case of fraud, and except as provided in section 6214(a) (relating to assertion of greater deficiencies before the Tax Court), in section 6213(b)(1) (relating to mathematical errors), or in section 6861(c) (relating to the making of jeopardy assessments).

• • • • •

Sec. 6214. Determinations by Tax Court.

(a) JURISDICTION AS TO INCREASE OF DEFICIENCY, ADDITIONAL AMOUNTS, OR ADDITIONS TO THE TAX.—Except as provided by section 7463, the Tax Court shall have jurisdiction to redetermine the correct amount of the deficiency even if the amount so redetermined is greater than the amount of the deficiency, notice of which has been mailed to the taxpayer, and to determine whether any additional amount, or addition to the tax should be assessed, if claim therefor is asserted by the Secretary or his delegate at or before the hearing or a rehearing.

• • • • •

In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 914

GEORGE R. TOLLEFSEN and MARGARET A. TOLLEFSEN,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (Pet. App. 9a-26a; R. 134-145)[1] are reported at 52 T.C. 671. The opinion of the court of appeals (Pet. App. 1a-8a) is not yet reported.

[1] "R." references are to the record appendix filed in the court of appeals.

JURISDICTION

The judgment of the court of appeals was entered on June 19, 1970. By order dated September 16, 1970, Mr. Justice Harlan extended the time for filing a petition for a writ of certiorari to and including October 31, 1970. The petition was filed on October 29, 1970. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the court of appeals correctly sustained the Tax Court's determination that cash withdrawals by petitioner[2] from an inactive, wholly owned subsidiary corporation, whose parent corporation was, in turn, wholly owned by petitioner and his wife, were taxable dividends and not loans.

STATUTES INVOLVED

The pertinent provisions of the Internal Revenue Code of 1954 are set forth in the Appendix to the petition (Pet. App. 27a-29a).

STATEMENT

Petitioner and his wife owned all of the stock of Tollefsen Brothers, Inc. ("Brothers"), which in turn owned all of the stock of Tollefsen Manufacturing Corp. ("Manufacturing"), an inactive corporation.

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[2] References to "petitioner" are to George R. Tollefsen. Margaret A. Tollefsen is a party hereto only because she filed a joint income tax return with her husband for the year in issue.

In 1960 and 1961, petitioner withdrew cash from Manufacturing in the net amounts of $27,810.97 and $24,665.40, respectively. The withdrawals were reflected as loans on Manufacturing's books and were evidenced by petitioner's non-interest bearing demand notes. At no time did petitioner pay interest on the funds withdrawn. Although he claimed that he withdrew the funds to carry on Manufacturing's business, he did not use the funds for this purpose, but rather to advance his own business interests. (Pet. App. 2a-3a, 22a-23a; R. 135-137.)

In June 1964, the Internal Revenue Service began the audit which ultimately led to the deficiency determination here in issue. Until that time, petitioner made no repayments of any of the funds withdrawn from Manufacturing in 1960 and 1961. Only thereafter did he make advances on behalf of Manufacturing for which he received credits totalling $11,916.80. The credits, although not formal repayments, were sufficient to offset in full the amounts of the first two notes which petitioner gave to Manufacturing in 1960, and they were marked to indicate repayment. As of the time of the Tax Court hearing, no repayments had been made on account of any of the 1961 withdrawals. (Pet. App. 3a-4a; R. 139-140.)

The Tax Court found on these facts and on the basis of petitioner's demeanor at trial that he had not intended, at the time of the withdrawals, to make repayment to Manufacturing. The Tax Court also found that the withdrawals were, in substance, distributions from Manufacturing to its parent, Brothers, which in turn distributed the funds to its sole

shareholders, petitioner and his wife. It held, in accordance with these findings, that petitioner's net withdrawals in 1961, the only year in issue, constituted taxable dividends from Brothers pursuant to Sections 301 and 316 of the Internal Revenue Code. (Pet. App. 21a-26a.) On appeal, the Second Circuit affirmed (Pet. App. 1a-8a).

ARGUMENT

The decision below is correct. There is no conflict or any other reason for further review.

1. The Tax Court correctly found that at the time of the withdrawals, petitioner did not intend to repay Manufacturing. This finding is supported by substantial evidence, as the court of appeals held (Pet. App. 5a), and there is, therefore, no occasion for review of the finding by this Court. *Comstock* v. *Group of Investors*, 335 U.S. 211, 214.

Likewise correct is the conclusion of the courts below (Pet. App. 7a, 25a-26a) that the transaction in question is to be characterized for tax purposes as consisting of two steps: first, a transfer of funds from Manufacturing to Brothers, and second, a constructive dividend distribution from Brothers to petitioner and his wife. This conclusion fully comports with the uncontroverted facts of this case; for it was petitioner's unfettered control over Brothers, which in turn controlled Manufacturing, that permitted him to compress what was essentially two steps into one, and thereby to withdraw funds from Manufacturing directly. See *Young* v. *Commissioner*, 5 T.C. 1251 (1945).

2. Petitioner's assertion of conflict (Pet. 14-16) with decisions of this Court holding that, in certain circumstances, a separate corporate entity is not to be disregarded rests on a misconception of the holdings below. Neither the Tax Court nor the court of appeals disregarded the separate existence of Brothers and Manufacturing. On the contrary, both recognized that Brothers and Manufacturing were separate entities by treating the transaction as a distribution of funds from Manufacturing to Brothers and a redistribution from Brothers to petitioner and his wife. The holdings below thus rest on the settled principle that the substance of a transaction, not its form, is determinative of the tax consequences. See, *e.g.*, *Knetsch* v. *United States*, 364 U.S. 361.

3. There is no merit to petitioner's claim (Pet. 20-22), advanced for the first time in this Court, that the Tax Court was without jurisdiction to determine that petitioner received a dividend from Brothers. This argument is based on the mistaken premise (Pet. 20) that "[t]he statutory notice of deficiency, the pleadings and the evidence heard by the Tax Court were confined to the issue whether subsidiary [Manufacturing] paid a taxable dividend in amount of $24,665.40 to petitioner." In fact, the Commissioner's contention was not so restricted either in the deficiency notice or in the Tax Court. The notice (see Pet. App. 21a) does not state from whom the dividend was claimed to have been received, but only that a dividend was received; the issue framed by the pleadings (R. 4-5, 134-135) is whether the Commissioner's determination is correct; and the Commis-

sioner argued in the alternative in the Tax Court (Reply Brief, p. 10) that the distribution should be treated as a dividend from Brothers. If petitioner had additional evidence on this aspect of the case, he should have sought to reopen the Tax Court proceedings.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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NOVEMBER 1970.

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